

AFAANZ PROJECT REPORT

(1) Name, Position, Contact Details for each applicant

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(2) Project Title:

Original title: The role of auditors in mitigating impression management and inconsistencies in other information

New title: Investigating investors' reactions to the consistency check paragraph in the auditor's report

(3) Updated Project Summary (500 words) including any variations between the project undertaken and the original application

In the original application, we aimed to collect data from auditors and expected to spend \$7,000 AUD on data collection and research assistance. However, we ended up being awarded \$2,000 AUD from the AFAANZ Grant. The grant awarded made us reconsider the research questions and participant type, in order to make the best use of this funding. We therefore decided to pursue a similar topic area, the role of auditing in the inconsistencies between other information and financial information in the annual reports, but examine the investors' decision making perspective instead of auditors' decision making. This is because investor participants are not only more practical to recruit, but taking the investor perspective allows us to contribute further to the existing literature in the broader topic area (see for example Cheng et al., 2015).

While annual reports include both financial statements and other information in response to users' information demand, any material inconsistencies between audited financial statements and the other information such as the management discussion and analysis (MD&A), regardless of whether they are due to mistakes, intentional impression management or fraud, can be misleading for investors. ISA 720 requires auditors to consider the nature of the inconsistent information and the extent that the report users are affected by this information when determining the materiality of the inconsistency and misstatement, and report whether there is a material inconsistency between the financial statements and other information. While the accounting impression management literature has examined the investors' reactions to the other information and the management's reporting choices (Rennekamp, 2012; Asay et al., 2017; Asay et al., 2018), they have not considered the investors' reaction to the auditors' comments on the consistency check.

Most audit firms adopt the boilerplate wording of the auditor's report as in ISA 720, which can reduce the usefulness of such communication on the consistency. Our study examines whether the revised wording of the auditor's consistency check paragraph, as adopted from

Dutch auditing standard 720, can enhance the usefulness of such communication. We also examine whether the auditor's consistency check paragraph has a more significant effect on the investors' judgments when the other information is reported in an integrated manner to the financial information (Integrated reporting) than when the other information is reported separately from the financial information (Separate reporting). We conducted an experimental study with a 2x4 between-subject design with the Reporting being manipulated at 2 levels (Integrated Reporting vs Separate Reporting) and the Audit Report being manipulated at 4 levels (No consistency check, Standard check, Revised check and Non-financial assurance). We recruited non-professional investors with investment experience and knowledge of corporate reports through Prolific Oxford. Prolific, located in the U.K., is an online subject recruitment platform, similar to Amazon's Mechanical Turk. Prior research indicates that Prolific is suitable for social science experiments, and Prolific respondents are diverse (Peer et al., 2017). Prolific has been used in other accounting studies (Murphy et al., 2019; Owens et al., 2019; Rennekamp et al., 2018). We find that the consistency wording has a marginally significant effect on increasing the reliability of non-financial information, in which the revised consistency check provides as high reliability as having non-financial assurance and the standard consistency check provides similar reliability level as having no consistency check at all. We also find that investors perceive non-financial information to be more important to their decision making when there is revised consistency check or non-financial assurance than when there is no consistency check or standard consistency check, especially when the non-financial information is reported separately from the financial information (not integrated).

(4) Funds Granted

\$2,000 AUD

(5) Detailed Report on Expenditure of Funds against Budget Items, with variations explained

Instead of auditor participants, we collected data from non-professional investors from Prolific Oxford instead to make the best use of the budget, which resulted in the change in research questions (as explained in the previous section). Prolific, located in the U.K., is an online subject recruitment platform, similar to Amazon's Mechanical Turk. Prior research indicates that Prolific is suitable for social science experiments, and Prolific respondents are diverse (Peer et al., 2017). Prolific has been used in other accounting studies (Murphy et al., 2019; Owens et al., 2019; Rennekamp et al., 2018).

Cost of data collection for investor participants: \$1,512 (approximately \$4.5 AUD per participant * 336 participants)

Due to COVID 19 complications in 2020 which have caused significant disruption to our research, teaching and personal lives, we plan to use up the remaining funding in early 2021 to run a follow-up experiment to increase the sample size and explore alternative explanations of the results.

(6) Outcomes, for example, working papers, presentations and publications (give full details, including abstracts)

We are working on the first draft of working paper, which we aim to send to future conferences such as AFAANZ and ISAR.

Abstract:

While ISA 720 requires auditors to consider the nature of the inconsistent information and the extent that the report users are affected by this information when determining the materiality of the inconsistency and misstatement, and report whether there is a material inconsistency between the financial statements and other information, most audit firms adopt the boilerplate wording of the auditor's report, which can reduce the usefulness of such communication on the consistency. Our study examines whether the revised wording of the auditor's consistency check paragraph, as adopted from Dutch auditing standard 720 can enhance the usefulness of such communication. We conducted an experimental study with a 2x4 between-subject design with the Reporting being manipulated at 2 levels (Integrated Reporting vs Separate Reporting) and the Audit Report being manipulated at 4 levels (No consistency check, Standard check, Revised check and Non-financial assurance). We recruited non-professional investors with investment experience and knowledge of corporate reports through Prolific Oxford. We find that the consistency wording has a marginally significant effect on increasing the reliability of non-financial information, in which the revised consistency check provides as high reliability as having non-financial assurance and the standard consistency check provides a similar reliability level to having no consistency check at all. We also find that investors perceive non-financial information to be more important to their decision making when there is revised consistency check or non-financial assurance than when there is no consistency check or standard consistency check, especially when the non-financial information is reported separately from the financial information (not integrated). Findings of this paper can inform audit firms about the usefulness of the consistency check paragraph in their report, and the conditions where the adoption of the revised wording from Dutch examples is beneficial.

(7) Future Intentions for this Project (give full details)

- a. Conference submissions: AFAANZ 2021, ISAR 2021
- b. Journal submissions: ABDC A*/A journals
- c. Grant applications: N/A
- d. Projects: N/A

(8) Summary of Outcomes and Benefits

To practice: Findings of this paper inform audit practitioners about the usefulness of the consistency check paragraph in their report, and the benefits of adopting the revised wording which expresses a “reasonable” level rather than a “limited” level of consistency opinion in

the standard wording of ISA 720, as investors perceive a higher level of reliability and relevance of non-financial information when the consistency paragraph follows the revised wording rather than the standard wording.

To standard setters and regulators: The study informs the standard setters of ISA 720 about the limitations of the current standard wording of the consistency check paragraph in the audit report, as the standard wording does not provide much benefits above the no consistency check condition. For the IAASB Integrated Reporting Working Group who are exploring the credibility-enhancing mechanisms for integrated reports and other extended reports, the study informs them about the potential downside of integrating financial and non-financial information, as the non-financial assurance and consistency check add more incremental value to the reliability and relevance when non-financial information is reported separately than when non-financial information is integrated with financial information.